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Sparks v. AT&T Corporation and Lucent Technologies, Inc.

EXPERT REPORT

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I have been asked to provide an expert report to Carr, Korein, Tillery, Kunin, Montroy, Cates, Katz and Glass, LLC, who represent the plaintiffs in this class action lawsuit. The general area of my expertise, and the subject matter of the report, relates to AT&T's consumer leasing program for telephone equipment for residential customers between the period 1984-1996. In the preparation of this report, I have reviewed the depositions and the relevant discovery¹ concerning AT&T's lease marketing plans and research, the consumer lease business unit plans, the consumer bill inserts and bill messages provided by AT&T, the training materials used for its AT&T customer service representatives, consumer complaint files and AT&T's summary of its complaints from lease customers, and internal AT&T staff documents produced in the normal course of AT&T's implementation of its consumer leasing business.

In order to help organize this material and to prepare this Report I have prepared a spreadsheet of the Key Events. This spreadsheet was helpful to me in organizing many of the documents I reviewed. However, it is important to note that this spreadsheet does not contain a reference to all the documents that I reviewed and it does not reflect all the documents and source materials for the statements in this Report. Rather, it should be

¹ I have reviewed materials provided by the plaintiff's law firm that were deemed relevant to the subject matter of this expert analysis. It is my understanding that AT&T produced in excess of 800 boxes of materials in response to discovery in this lawsuit. I have not reviewed all of these boxes. However, it is my understanding that the law firm has reviewed these materials and forwarded to me those materials deemed relevant to my expertise. In my estimation, I have reviewed 8-10 boxes of materials that were identified by the plaintiffs' attorneys as relevant to the topics of this expert report.

viewed as a guide and not a complete source of all the materials and documents I reviewed or relied upon. For example, the depositions are not reflected in this spreadsheet. Nor are the many customer complaints and bill insert materials that I reviewed. Finally, this spreadsheet does not reflect some discovery materials that arrived in the past several weeks and that I consulted in the preparation of my Expert Report, but did not have time to reflect in the spreadsheet itself.

Background and Qualifications.

1. I am an attorney and consultant on consumer protection, service quality, and low-income programs associated with the move to competitive energy and telephone markets. My consulting business has assisted state utility regulatory commissions and state public advocates, as well as national consumer organizations, in the development of policies, regulations, and programs to regulate competitive energy and telecommunications providers to assure an adequate level of consumer protection for residential customers in the transition to competitive markets. Prior to opening my consulting practice in 1996, I was the Director of the Consumer Assistance Division of the Maine Public Utilities Commission for 10 years. During the period 1979-83, I was the Superintendent of the Bureau of Consumer Credit Protection in Maine, supervising grantors of consumer credit for compliance with the Maine Consumer Credit Code, Truth in Lending Act, Fair Debt Collection Practices Act, and the Fair Credit Reporting Act. My resume is attached to this Report.
2. I have frequently testified in New Jersey on that state's consumer protection and unfair trade practice laws and regulations, appearing as an expert witness on behalf of the Division of Ratepayer Advocate before the Board of Public Utilities. My comments and testimony have addressed the enactment of consumer protection regulations that should govern competitive energy marketers under that state's energy restructuring legislation. In the course of my work for the Division of Ratepayer Advocate I have studied and spoken about the interaction between the Board of Public Utilities and the New Jersey

Consumer Fraud Act (and other consumer protection laws) in the Board's oversight role in regulating competitive energy marketers.

Summary of Opinion.

3. In my opinion, the consumer lease programs operated by AT&T (the "Company") resulted in exorbitant prices charged to "embedded base" residential customers for "Big Six" telephone sets. By "embedded base" I mean those customers who retained their telephone sets after the end of the transition period in 1986 and who then became lease customers of AT&T by default. As I explain further below, the price charged to these customers was exorbitant in relationship to the value of the telephone set and in relationship to the value of the leasing service provided by AT&T. Because the price charged to these customers was exorbitant in relationship to the value of the lease or the telephone set itself, this program and the price charged to customers was unconscionable in my opinion. In the attempt to retain consumer lease customers, AT&T used unfair and misleading practices in structuring its "month to month" consumer lease, in communicating with its customers about the leasing of telephone equipment, in responding to customer complaints and inquiries about leasing, and in the pricing of its leased telephone equipment for residential customers. As a result, many customers paid an enormous sum for a telephone set that could have been purchased either from AT&T or alternative suppliers for far less. Furthermore, the services AT&T provided to its lease customers did not justify the prices and the price increases imposed on lease customers during the 1986-1996 period. The consumer lease program resulted in millions of residential customers paying monthly charges to AT&T to keep one or more telephones in their homes that were far in excess of the value of any telephone set that could have been purchased in the competitive market and far in excess of any value that was delivered to these customers as part of their leasing agreement. AT&T collected these monthly charges (most of which were billed on a quarterly basis) and made huge profits by taking advantage of the ignorance of many its residential

customers and their confusion about the nature of the changes in the telephone industry. The Company undertook substantial research about its customer base, particularly the extent of the knowledge of their customers about leasing telephones and the reasons why they continued leasing telephone sets from AT&T after customers were offered the option of purchasing telephone sets in 1984. The Company then constructed a method of marketing, billing, and providing information to their customers designed to maximize the profits from leasing, and take advantage of the growing evidence that the residential customers who continued to lease, particularly those who were elderly, leased from habit, inertia, or confusion, and not because they understood the nature of the transaction or the choices available to them.

4. My evaluation and opinion has been informed by my experience in the implementation of Maine's consumer credit protection laws, my experience in the development of consumer protection and customer education regulatory policies and programs to oversee the transition to retail energy and telecommunications competition in many states, and specifically my experience with respect to the implementation of retail electric, natural gas, and telephone competition in New Jersey.
5. As I reviewed the AT&T consumer leasing history and the manner in which AT&T structured its consumer lease of telephones for residential customers, I was struck by the similarities with consumer transactions that were the subject of newly developed legislation and regulations in the 1980's concerning consumer leases, installment sales acts and rent-to-own transactions. When I was the Superintendent of the Maine Consumer Credit Code, I sought to enforce the interest rate limitations of the Code for a rent-to-own business that had enticed consumers into extremely expensive rental agreements that promised consumers the option to own the television. If these agreements had been treated as a consumer credit sale, the interest rate (finance charge) would have greatly exceeded the state finance charge limits applicable to consumer credit sales. Similar to the efforts of AT&T with its

consumer leasing program for pre-1984 residential customers, the purveyors of the rent-to-own scheme evaded the jurisdiction of state and federal credit disclosure and interest rate laws because they alleged that their agreements were not credit sales and the customer could terminate the transaction at any time and not be liable for any further charges. In fact, the rent to own business that I attempted to regulate as a consumer credit sale was successful in its legal challenge², but the end result was a flurry of state and federal consumer leasing and other specific regulatory activity designed to prevent the most egregious aspects of these transactions. For example, Maine enacted Article XI of the Maine Consumer Credit Code, Rental-Purchase Practice (9-A M.R.S.A. §§11-101-11-121) in 1991 that required certain disclosures for rental-purchase transactions and mandated that the total number of rental payments necessary to acquire ownership of the property under any rental-purchase agreement could not exceed two times the cash price of the property so that when 50% of the rental payments made by the consumer equals the cash price of the property, the consumer acquires ownership of the property and the rental purchase agreement terminates. (9-A M.R.S.A. §11-114). AT&T knew that a number of states had enacted remedial statutes relating to rent-to-own transactions in which ownership of the goods is automatically transferred to the customer when rental payments exceed a certain level, typically 200% of the cash price.

6. AT&T's consumer lease was structured as a month-to-month lease so that they did not have to make disclosures required by the Consumer Leasing Act, which is part of the federal Truth in Lending Act, because those disclosures are triggered when the term of the lease is for 4 months or more. As a result, AT&T's consumers were never informed of the term of the lease, the value of the product being leased or the value of the product at the end of the lease. AT&T intended to structure the lease so that legally

² Hawkes Television, Inc. v. Maine Bureau of Consumer Credit Protection, 462 A.2d 1167 (Me. 1983).

the customer did not have the option to purchase the telephone set that was being leased after 1986.³ However, the key point is that this transaction was designed so that the customer was never told the retail value of the telephone set, total price of the telephone set (i.e., the total of lease payments), was never offered the option to buy the telephone set after the 1984-86 transition period, and, as a result, paid a monthly or quarterly bill for many years that vastly exceeded the true value of the equipment or the service associated with the lease. Of course, what made this scheme even worse is that these customers never affirmatively entered into these transactions. These customers never signed any lease agreement or saw any preprinted disclosures prior to formalizing the lease agreement for their telephones. Rather, AT&T was "given" these consumers at the end of the transition period, during which leasing customers had the right to purchase the telephone or terminate the lease and purchase a telephone from other manufacturers of telephone equipment. AT&T took full advantage of this opportunity to retain lease customers and conducted its business and its communications with customers in a manner designed to prevent customers from finding out the true economic value of the lease arrangement or understanding their rights in obtaining telephone equipment in a rapidly changing telecommunications world.

7. I was also struck by the similarities between the telephone leasing program and the implementation of inside wire deregulation. As with telephone equipment, the FCC deregulated the provision and maintenance of inside telephone wire, that portion of the telephone wire that runs from the telephone company's network interface at the customer's residence and the telephone set owned or leased by the customer inside the house. Shortly after the deregulation of this service, local phone companies began selling an inside wire maintenance product to their customers that promised to fix and maintain a customer's inside wire for a monthly fee. Telephone companies sold this product to many customers

³ As I explain further below, the reality is that AT&T often informally made the telephone set available to the customer as a Sale in Place or charged the customer a fee for failing to return the leased telephone that was close to the value of the telephone set.

who did not understand that they could fix the wire themselves (or have any electrician fix it) or that inside telephone wire rarely needed fixing or repair. Many state regulators initiated proceedings to regulate phone company practices with respect to the sale of this product and, in a number of states, customers themselves sued the phone company to seek damages for the unfair and deceptive marketing practices for this product⁴. Here, we have a relatively small monthly fee being charged for a telephone equipment lease that is relatively similar to inside wire in that customers were confused and often did not understand the nature of the transaction or that the price of the "lease benefits" were far less than the value of the lease rate that was charged for a multi-year period. Unfortunately, unlike the situation with the inside wire maintenance, the state public utility regulators did not have jurisdiction over AT&T's rates since they were prohibited from regulating the price for long distance service or the sale or lease of telephone equipment. As a result, unlike the local telephone companies, state regulators had no regulatory interface with AT&T. Furthermore, neither state nor federal utility regulators knew the size or scope of AT&T's consumer leasing business and did not, in the normal course, understand the nature of the efforts AT&T undertook to retain leasing customers.⁵ While the state Attorneys General had jurisdiction over any unfair and deceptive trade practices committed by AT&T in the sale or leasing of telephone equipment, it is highly unlikely that these offices knew or had the capacity to find out the size or scope of AT&T's consumer leasing business with respect to embedded base customers since AT&T carefully structured the lease to avoid the any clear cut jurisdiction associated with either consumer leasing or consumer credit sale regulations.

⁴ Since the local phone companies had to get their customers one-by-one, they often resorted to signing up customers for wire maintenance plans by tactics that included negative option, bundling the product with other optional services, or misleading customers as to the necessity for the product. This was unlike AT&T who was given all the embedded base customers at the end of the transition period.

⁵ In response to press inquiries concerning the announcement of price increases for leased telephones, AT&T routinely refused to provide information on the scope of its leasing business on the grounds that this information was competitively sensitive.

8. Finally, it should be clear that my concerns relate to the transactions between AT&T and residential customers concerning the embedded base telephone sets that were transferred to AT&T in 1984 and who then remained with AT&T as a lease customers starting in 1986 (the end of the transition period). These customers should be distinguished from those customers who affirmatively entered into short term lease arrangements with AT&T for telephone sets after 1986.

My Report is organized primarily in chronological order beginning with the creation of AT&T's consumer leasing business in 1984.

The Transition Period, 1984-86

9. Until 1984, residential customers received one bill for telephone service from "the phone company." This bill included local service, long distance service, and the cost of renting telephone sets. Up until this period, telephone sets were considered a part of regulated telephone service and state public utility commissions regulated the monthly rates for telephone sets provided to customers by the local telephone company, as well as the rate for local telephone service. This changed when the Federal Communications Commission adopted a policy of "deregulating" telephone equipment that reached fruition at the same time that the break up of AT&T was ordered under the terms of the anti-trust litigation initiated by the U.S. Justice Department. Under the terms of the Modified Final Judgment, Regional Bell Operating Companies were allowed to provide local exchange telephone service. AT&T was not allowed to enter the local telephone service market, but was "anointed" as the default provider of interstate long distance service and rental telephone equipment.
10. Pursuant to an order of the Federal Communications Commission in late 1983 to implement the deregulation plan for telephone equipment, the telephone sets in service were transferred to AT&T from

the various state-regulated Bell companies and state authorities were preempted from regulating the price or terms of service for the lease or sale of telephone equipment. AT&T informed customers in writing that they had the right to purchase the telephone sets they were leasing with a brochure that was provided to all customers in December 1983. This brochure was issued only once during the holiday season. At this time, customers were charged approximately \$1.50 per month for a traditional rotary telephone, although the monthly rate varied among the local Bell telephone companies that issued bills to local exchange service customers. The intent of this brochure was to inform the customer about changes in the telecommunications industry and the customer's right to continue leasing their phone(s) from AT&T or to purchase the phone(s) at a price listed in the brochure. These prices were listed as "AT&T maximum prices, 1/1/84 to 1/1/86" and ranged from \$19.95 for traditional rotary telephones to \$54.95 for Trimline touch-tone telephones. The lease rates were listed as monthly (\$1.50 for traditional rotary to \$4.60 for Trimline touch-tone). The text of the brochure did not inform customers that their right to purchase the leased telephone would expire in two years. The only reference to the limited nature of this right was in the description of the price chart quoted above.

11. Furthermore, the prices were not presented in a manner that allowed easy comparison between leasing and purchasing the telephone. The purchase price was presented as a lump sum, but the lease rates were presented as monthly rates. For example, customers were not informed that if they paid \$1.50 per month for two years, they would have already paid \$36 for the same phone that could be bought for \$19.95. The lack of similarity in price comparisons for many products has led to customer confusion and allowed for unscrupulous marketers to take advantage of customer ignorance, particularly those who are vulnerable and less educated. There are many examples in the field of consumer protection regulation that reflect this concern. For example, all consumer credit transactions must present the consumer with a disclosure of the interest rate or finance charge in uniform manner and uniformly label

this disclosure as the Annual Percentage Rate. Food content labels must disclose nutritional content in a uniform manner according to U.S. Department of Agriculture regulations. Many states that have moved to retail electric competition are requiring energy marketers to disclose prices in a uniform cents per kwh manner. All of these regulatory initiatives have occurred because it is clear from customer research that many consumers either cannot or will not compare the prices of similar goods and services if they are presented in different pricing formats.⁶ Therefore, it is unlikely that many consumers understood the difference between purchasing and leasing the telephone after only one brochure issued during a busy holiday season.

12. Furthermore, the general confusion about the break up of AT&T only exacerbated the lack of understanding about the lease-purchase decision for the telephone. It is not surprising that many customers in fact did nothing at that time and continued to pay a monthly fee for leasing the telephone service, particularly when the bill for this service continued to come from the local Bell company as part of the customer's local telephone service for several years. Furthermore, customers were repeatedly told in this brochure, in bill inserts issued by local telephone companies, and in AT&T's television advertisements that customers could continue to rely on their "old reliable" telephone and "do nothing" and continue to maintain phone service. For example, one bill insert by New Jersey Bell issued in January 1984 was labeled a "Customer Service Guide" and purported to "help you understand how these changes affect your telephone service." The box labeled "Phone Equipment" never informed customers that they could purchase their telephone or what price would be charged for purchasing the phone. Instead, customers were told that the phone equipment had been transferred to AT&T Information Systems on January 1, 1984, and that new rates would be charged for leasing the telephone

⁶ There has been extensive research conducted with both the formulation of the food content labels and the adoption of uniform price disclosures for the retail sale of electricity. These studies, which include the results of customer surveys and interviews concerning the customer's ability to compare prices or units presented in different formats, can be accessed at the website of the Regulatory Assistance Project, Gardiner, Maine, www.rapmaine.org. See in particular, "Label Testing: Results of Mall Intercept Study," National Council on Competition and the Electric Industry, October, 1998.

equipment. In bold print at the top of the brochure was the following statement, "REMEMBER, THOUGH, IF YOU DO NOT WANT TO MAKE A CHANGE IN THE SERVICE YOU HAVE NOW, YOU DO NOT HAVE TO DO ANYTHING!"

13. Customers were confused about the changes in their telephone service, the break up of AT&T, and the theoretical move to competition for long distance telephone service and telephone equipment. AT&T's complaint files and their own surveys document that customers were confused about the nature of the bill received from AT&T for leased telephone equipment. Many customers, particularly elderly customers, thought the lease bill was for some aspect of their telephone service. Other independent surveys documented customer confusion as well. A survey of Pennsylvania residential customers⁷ about changes in the telecommunications industry conducted in mid-1985 documented that while a majority (73%) of customers were able to explain their lease or buy options for telephone equipment, but that 20% could only do so with a prompt from the interviewer and 7% did not in fact know about their options. More importantly, the study documented that this knowledge was directly related to education and income level, with the lower income and less educated consumers showing a significant lack of knowledge. Those who lease are typically less well educated and older. One-half of those who lease were 45 years of age or older and more likely to have a high school education or less. Finally, the study found that about one half of the people who lease give passive reasons for leasing their phones. Specifically, 44% stated that they "always leased", the phone was there when they moved in, they were still deciding, or had not gotten around to changing. Another 8% stated that they did not know why they leased. As a result, more than 50% of those surveyed either leased from habit or inertia or did not know why they leased.

⁷ Hyman, Drew, "Telecommunications and Consumer Education: An Analysis of Consumer Attitudes, Practices and Beliefs, Pennsylvania State University, University Park, PA, CSIS Project, S-203, Human Development, 16802, 1986.

14. Other than the brochure sent in December 1983, there is no evidence that AT&T informed customers during the 1984-86 period about their right to purchase the leased telephone, the price for purchasing the phone, or the terms under which customers could continue to lease from AT&T. It does not appear that AT&T specifically informed customers that the right to purchase the phone of the December 1983 prices would expire by the end of 1986. In fact, after the 1983 brochure, AT&T's advertising and communications with customers were designed to retain leasing customers and were not educational in nature. Rather, AT&T conducted a national TV advertising campaign designed to lull customers into the option of doing nothing and remaining lease customers of AT&T. Even the bill inserts provided by local telephone companies were not helpful to customers in making sure that they understood their rights with respect to leasing or purchasing the telephone already in their homes. It was not until sometime in 1987, by way of a two-three sentence printed bill message, that customers were informed that their right to purchase had expired.
15. While there was a large erosion of the lease customer base in the 1984-86 period, from over 100 million telephone sets in 1981 to 40 million in mid-1986, the erosion rate was not as high as expected by AT&T and lease profitability continued to increase in the following years.

AT&T Billing, Pricing, and Lease Retention Marketing Efforts, 1986-1993

16. Starting in 1985, AT&T assumed sole responsibility for billing for consumer leasing services for most customers. These bills were issued quarterly if the customer leased less than three telephones or had charges of less than \$12 per month. As a result of this policy, about 90% of the residential customers were billed quarterly. In addition, AT&T initiated a national practice of billing in advance (either quarterly or monthly), which had not been the practice in all jurisdictions in the past.

17. During the period 1986-1996, AT&T's consumer lease bills were not itemized unless the customer replaced the telephone set or unless AT&T initiated a price increase. AT&T's customer bills for leasing emphasized the "service" provided to the customer, the AT&T connection, the AT&T logo, and emphasized the quality and "peace of mind" that would be provided by AT&T to its customers. Even though these bills did not contain charges for AT&T long distance service, AT&T's bill messages and inserts marketed AT&T long distance service and, in my opinion, allowed customers to think that the bill had some relationship to AT&T long distance phone service or telephone service in general. While equipment that was leased by the customer was listed for each price increase ordered by AT&T on the month or quarter prior to the effective date of the price increase (generally, every other year beginning in 1986), this listing was abbreviated and, therefore, often unclear. For example, the traditional rotary desk phone was listed on the bill as "TRAD ROT DSK MISC" for the 1986 price increase. Furthermore, this separate listing only appeared for the specific telephone model that was the subject of the price increase so that customers who leased a telephone model that was not the subject of a price increase did not receive any bill itemization.
18. By the time of the mid-1986 price increase, AT&T increased the monthly rate for a traditional rotary desk telephone from \$1.50 to \$2.25, a 50% increase. Customers were informed of this price increase in a 2-3 line bill message one billing period prior to the effective date of this price change. At the time of this price increase, a customer with a traditional rotary desk telephone would have already paid \$45 for a telephone set that was listed in the December 1983 brochure as available for purchase for \$19.95. This represented more than 200% of the purchase price, an amount that would have triggered the transfer of ownership of the item under many state retail installment sales acts. It was at this time when AT&T increased rates for embedded base residential customers of Big Six telephone sets that AT&T's conduct became unfair and the prices were unconscionable, in my opinion. This was exacerbated

through the next ten years with a constant parade of rate increases for telephone sets that were not worth the price of the lease over a long-term period or the lease services that AT&T purported to provide.

19. AT&T never issued any educational materials during this time period. Rather, AT&T's communications with its customers were designed to continue the leasing relationship and maximize the profitability of a transaction that would never have been entered into by the vast majority of these customers as a positive transaction. Instead, AT&T took advantage of the "negative option" approach that lulled customers to do nothing and continue paying for leasing a telephone set. This basic "inertia" that AT&T documented well in its own marketing studies resulted in millions of customers paying a relatively small quarterly bill from AT&T when AT&T knew some customers did not understand the purpose of the AT&T lease bill or that they could purchase a telephone from another competitor and still receive long distance telephone service from AT&T. In fact, AT&T understood that many of the customers who terminated the lease arrangement did so after choosing another long distance carrier so that AT&T wanted to continue linking the provision of telephone service with telephone equipment leasing in customer's minds.

20. AT&T's ability to take advantage of its residential customer base was enhanced further by the lack of any competition to its leasing business. While there were competitors in the sale of telephone sets to residential customers, even by some telephone companies that billed customers for local exchange service, there was no national competitor for leasing telephone sets to the residential customers served by the Regional Bell Operating Companies that provided local exchange service to the vast majority of U.S. households. As a result, AT&T was the default provider of a key component of local telephone service without any competitive provider of that service to operate as a damper on its ability to price and undertake actions to maximize its profits as long as its customers continued to pay the quarterly bill. AT&T had every incentive to retain the customer and no competitive pressure to ameliorate its

- marketing or pricing tactics for its most vulnerable customers, particularly the elderly who were confused about the changes in the telephone industry, as documented by AT&T in its own research.
21. AT&T knew as early as 1986 that over 1/3 of its residential customers leased due to "inertia" or "habit" and that the elderly in particular were confused about the changes in the telephone industry. In 1988 AT&T knew that when asked why residential customers leased their phones, almost 35% did not know why they leased a telephone from AT&T, and an additional 36% leased for passive reasons that did not reflect any positive decision to lease, but reflected habit and inertia.
22. AT&T knew that the economic value of leasing was minimal, that the lease of a traditional rotary telephone "paid" for the services delivered to those customers after 5 months or less⁸ and that the annual erosion of its customers base was far less than expected (based on the economics of leasing and AT&T's own predictions) in the late 1980's and early 1990's. This lack of erosion was due to the retention marketing strategies implemented by AT&T, and the lack of customer education by AT&T on options and pricing decisions associated with leasing telephones, even from the earliest days of the creation of the deregulated telephone equipment market. During the late 1980's erosion of the lease base decreased 28% in 1984, 22.7% in 1985, 20% in 1986, and 17% or less in 1987. By 1989, there were still 20.5 million embedded base telephones being leased.
23. By 1993, AT&T's own profit analysis showed that the breakeven point for a Traditional Rotary Desk phone was 5.8 month and that the profit over 36 months was \$110.83 and that the average location life for this telephone set was 45.6 months at a lease rate of \$4.45 per month. In a memo to customer service representatives, an AT&T executive informed his employees that they should work hard to SAVE a lease when customers called with questions or complaints because there was a "huge profit" in retaining a lease, pointing out that the profit for retaining the lease for an additional 12 months for a

⁸ One such analysis in 1987 showed that the lease of a traditional touchtone desk phone for 48 months resulted in \$170.48 in gross revenue, but that the total expenses to serve that lease phone was only \$20.40. As a result, the "contribution" breakeven point was reached in 4.75 months. DCR-00265826.

Traditional Rotary Desk phone is \$44.04 and \$110.83 for 36 months, while the breakeven point for this same product was only 5.8 months.

24. AT&T structured its leasing program to avoid state rent-to-own legislation and federal consumer leasing legislation so that customers were never presented with full and complete disclosures. If this transaction had been structured as an installment sale, customers would have been informed of the "interest" charged on such a long-term purchase of a relatively inexpensive product. If this transaction had been structured as a regulated consumer lease, customers would have been informed of the lease rates, whether the customer had the option to buy or own the telephone, the term of the lease, the specific penalties for early termination or the costs associated with termination of the lease, the specific warranties and guarantees applicable to the leased property, and, most importantly, a description of the leased property, including, at least under the Maine law, its capitalized cost.⁹ Most importantly, these disclosures would have been made in writing "in a clear and conspicuous manner" prior to the consummation of the lease. (15 U.S. Code, §1667a) Instead, AT&T attempted to structure its lease program so that customers could not purchase the phone that was the subject of the lease, thus avoiding important disclosures required by state consumer protection laws, even though most embedded base customers paid over 200% of the value of the product after 2-3 years of leasing, a trigger that would have resulted in a transfer of ownership in many state retail installment sales acts.
25. AT&T's bill disclosures and bill inserts were designed to reinforce the concept of the "negative option" approach and avoid "shaking the inertia tree." None of these inserts provided real education about the changes in the phone industry or the customer's ability to purchase a telephone or the total payments made by the customer for the leased telephone equipment. When a customer called to question lease payments or the decision to lease, the company attempted to *SAVE* the lease and structured its offers to incite the customer to continue to lease telephone equipment from AT&T.

⁹ See, e.g., Maine Consumer Credit Code, 9-A M.R.S.A. §8-207.

26. While technically not able to purchase the leased telephone, many thousands of customers were in fact allowed to keep the leased telephone if they complained long enough. Of course, AT&T trained its customer service representatives to retain a customer's leasing business and make small offers or discounts to retain the lease. It was not until 1993 that AT&T structured its billing and collection computer to prohibit its customer service representatives from allowing the customer to keep the phone and avoid further leasing payments, thus effectively purchasing the leased telephone set.
27. The Six Guarantees provided by AT&T to its customers who leased telephone sets were either not useful compared to the lease rates charged to the customer over a long period of time or not used by most customers. The Six Guarantees that AT&T emphasized as the basis for the lease agreement were:
- Superior quality products, designed especially for you. Each one is built with the finest materials and backed by a century of AT&T manufacturing experience.
 - Free, immediate, same model replacement of your leased products at the many AT&T owned Phone Centers and AT&T authorized Service Agencies nationwide, no questions asked. We'll even replace your long cord with a new one.
 - Flexibility to choose the products that fit your needs, from free color exchanges to phones with more or fewer features. Special Lease programs are available with different exchange conditions. Call us for details.
 - Freedom to move your leased products with you anywhere in the continental U.S.
 - Free shipment of leased products to your home or office.
 - Toll-free Lease Customer Helpline, call 24 hours a day, 7 days a week for answers to any questions about leasing.

These promises do not provide an economic justification for the prices charged and routinely increased by AT&T during the 1986-96 period for the long term leasing of household telephone equipment. Some

of the Guarantees were illusory. For example, the "freedom" to move the leased product was not available to those with party line phones or hardwired telephones. Furthermore, the owner of any telephone could move the phone with them to any location as well so that this benefit was not related to leasing (as opposed to the purchase) a telephone. The repair benefit was clearly most important to leasing customers, according to AT&T's own research, but AT&T did nothing to clarify the misapprehension of many of its leasing customers that the cost of a premise visit to make a repair was not included in the lease rates and that customers had to either physically remove the phone and take it to a Phone Center or contact AT&T for a mailing package to send away for repairs. Most of the Guarantees were reduced in quality and quantity starting in the early 1990's when the number of phone centers were reduced and finally all closed in 1995, when the "24-hour" customer service at the toll free customer service line was reduced to normal business hours, when the number of customer service representatives and call centers were cut to reduce costs and maintain operating revenues, and when the leased phones were repaired and replaced with "refurbished" models and not new or modern telephone sets. AT&T knew that most customers did not seek repairs for the leased telephone set and that if they did seek replacement, the cost of providing a refurbished telephone was minor. One calculation by an AT&T executive showed that only an average \$9.48 was provided to lease customers in lease benefits, but he admonished himself, "Don't show this way."

28. Customers who had hard wire or party line phones were particularly taken advantage of because they could not easily replace their telephone sets with purchased models without a complicated and time consuming hard wire conversion or alteration to the telephone set itself. AT&T knew or should have known that many elderly leasing customers in particular had hardwired telephone sets and that the modular conversion kits offered to them were confusing and unlikely to result in a conversion to a modular connection without an expensive premise visit.

29. Because of its market dominance and its captive customer base, AT&T was able to increase the price for leased telephones to its pre-1984 customers with a wide range of discretion. These repricings resulted in an increase in the monthly rate for a traditional rotary telephone, which was not even manufactured after 1984, from \$1.50 to \$4.45. AT&T relied on the inertia of its lease base to maximize the profitability of its consumer leasing business. These price increases were not justified by the increased cost of the "lease guarantees," but were rather an attempt to increase its operating revenues and profits from a customer base that often failed to understand that they were leasing telephones or that was confused about the changes to the telephone industry and responded favorably to the image of AT&T's portrayal of the lease agreement as a "service".
30. When customers called to complain about the lease prices or inquire about any aspect of the lease agreement, including how to terminate the agreement, AT&T trained its customer service representatives to attempt to "SAVE" the lease by emphasizing the comfort and peace of mind that would come from continuing the lease. All of these efforts were designed to retain the lease and hide the true economics of the lease compared to the purchase of a telephone. Some customers who complained or who called to question the lease terms were offered reductions in lease monthly rates for a period of time. Other customers who complained strongly were allowed to keep their leased telephones and pay a small "Purchase Option Charge" even though the lease terms and conditions stated that the customer could not purchase the phone they were leasing and AT&T knew that allowing customers to purchase the leased telephones would subject the company to state retail installment sales acts and consumer lease disclosures that would make the uneconomic aspects of the leasing agreement plain to an otherwise ignorant consumer.
31. AT&T never formally informed customers of the terms of their lease agreement with customers during the 1984-93 period. It was not until 1993 that AT&T issued a "Lease Contract" to its customers, which

was the first written notification of the terms and conditions of the lease agreement. Customers were informed in this document that they did not have the right to purchase the leased telephone, but this information was buried in the fine print under "Other Terms and Conditions."

32. During this period AT&T conducted numerous marketing and demographic studies of its customers base and knew that "continuing" leasers [those who were not active in replacing or upgrading their leased telephones] were disproportionately older and poorer compared to other leasers and that such customers were confused about changes in the telephone industry. AT&T did nothing to educate its customers and carefully constructed marketing scenarios and training programs for its customer service representatives that were designed to make sure that customers were not informed about their right to purchase a telephone set of their choice or that they were in fact continuing to lease telephone sets from AT&T at rates that were greatly in excess of prices charged for telephones available for sale that were comparable to those being leased from AT&T. AT&T was careful to make sure that it did not market products to its lease customers that were comparable to those being leased so that customers of traditional rotary and touchtone telephone sets never saw lease bill inserts that offered comparable telephone sets for sale.

AT&T's Response to Consumer Groups and FTC/FCC Interest in Leasing, 1995-96.

33. Beginning in 1995, AT&T was publicly criticized by national consumer organizations about its consumer leasing program for residential customers, particularly for elderly customers who had been paying for leased telephones since before 1984 at rates that would have allowed the purchase of many comparable telephones. AT&T responded to these initiatives and the growing interest of the Federal Trade Commission to its leasing business by increasing its disclosures of lease terms and conditions to its customers, initiating a monthly/quarterly itemized bill in 1996, and issuing a brochure that, for the

first time since December 1983, informed its lease customers about the option to purchase a telephone. These initiatives were helpful, but "too little, too late" in many respects.

34. In the course of responding to FTC and consumer group interest during this time period, AT&T failed to disclose all that it knew about the demographics of its lease customer base, the number of customers who had been leasing telephones since 1986 (the end of the transition period), and, in particular, did not reveal its own internal research that indicated the significant group of customers, many of whom were elderly, remained confused about the leasing agreement, the purpose of the AT&T bill, or the economics of leasing versus purchasing a telephone. Nor did AT&T reveal its efforts to prevent customers from terminating a lease when they called the AT&T 1-800 customer service number.
35. AT&T's 1996 brochure to its customers concerning the economics of leasing and purchasing did not in fact explain to customers that the rates they had paid since 1984 for telephone sets had paid for a purchased telephone many times over. AT&T used this brochure to again emphasize the benefits of leasing, particularly the repair or replacement guarantee, but AT&T knew that telephones in general and AT&T's phones in particular did not break or need replacement due to defects or injury very often.
36. Customer complaints continued to escalate during this period and AT&T's response was often discriminatory in that similarly situated customers were treated differently. While some customers who hired lawyers or who contacted state officials and persisted in their claims that they had not been leasing telephones for many years or had returned the AT&T telephone many years ago received substantial settlements (e.g., over \$1,000), other customers who wanted to terminate their lease or who claimed they had never leased from AT&T or did not have the telephone equipment were only offered a 1-3 month adjustment. In fact, AT&T's computer did not have the information available to customer service representatives to calculate rebates beyond 1992 during this period because the customer's payment history and lease payment information was not available. AT&T knew that many of its elderly

pre-1984 customers did not understand the purpose of the AT&T bill for leased equipment and that many of them had hard wired phones that were difficult to remove.

Conclusions:

37. AT&T's practices with respect to communications, disclosures, pricing, and interactions with its embedded base residential customers were unfair and resulted in exorbitant and unconscionable prices charged to these customers beginning in mid-1986 when AT&T began to charge unregulated rates for leased telephones to these customers.
38. AT&T's practices in regard to its leasing program for pre-1984 residential customers are directly contrary to what regulators and policymakers are ordering with respect to the transition to electric, natural gas, and local exchange telephone competition for residential customers. In most states, customers are being provided with service from their current utility provider at a capped or frozen price during a transition period, but the default provider is not allowed to market competitive programs to such customers and the default provider is being required to provide repeated and extensive consumer education materials and messages to such customers about the development of the competitive market and the role of the default provider in this market. Default services in these states will remain subject to state regulation for price and service quality for an indefinite period.
39. AT&T's consumer leasing program was structured to evade the intent and jurisdiction of consumer protection legislation and policies applicable to retail installment sales acts and consumer lease disclosure acts enacted in most states in the 1980's and 1990's, particularly with respect to "rent-to-own" programs. However, the purpose of such state initiatives was to prevent the type of abuses that are evident in the AT&T consumer-leasing program for pre-1984 residential customers. AT&T avoided mandatory disclosures by structuring the lease as a month-to-month transaction, but the lease customers

never entered into such a transaction affirmatively and were not informed of the terms and conditions of their lease until 1993. Furthermore, AT&T never disclosed to its lease customers what it would cost to purchase the phones that were being leased by pre-1984 customers because AT&T claimed that the customer could not legally purchase the telephone that was being leased after 1986. AT&T's disclosure of the customer's right to purchase the leased telephone in the 1984-1986 period occurred only once and was totally insufficient to educate customers about their rights. The company never disclosed the total of payments being made by its customers or compared the lease payments to the cost of purchasing a telephone for any individual customer. Even though AT&T collected far more than 200% of the purchase price of the leased telephone from millions of pre-1984 residential customers, it never disclosed either the total of the lease payments or the price of a telephone comparable to the one being leased by its residential customers.

40. AT&T's conduct was particularly unconscionable with respect to its elderly customers. AT&T knew at an early implementation of its consumer-leasing program that those pre-1984 residential customers who were not active in using its lease guarantees were older, poor, and confused about the nature of the changes in the telephone industry that occurred in the 1984-86 period. AT&T knew that a significant number of customers were confused about the purpose of the separate bill received from AT&T for lease payments and that many customers assumed that their lease of telephones was related to the receipt of telephone service (long distance service) from AT&T or that the bill was connected to their ability to make and receive local telephone calls. The Company structured its lease communications to such customers so as to allow such confusion to continue and collect lease payments from such customers for Big Six telephone sets that were not "worth" the total of the lease payments being paid over the 10-year period in question in this proceeding. Lease payments totaling in excess of \$1,000.00

for a telephone set that could have been purchased for \$19.95 in 1984-1986 were made by customers who were taken advantage of by "old reliable."